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Financial Accounting Series

EXPOSURE DRAFT

Proposed Interpretation

**Consolidation of Certain
Special-Purpose Entities**

an interpretation of ARB No. 51

This Exposure Draft of a proposed Interpretation is issued by the Board for public comment. Written comments should be addressed to:

Director of Major Projects and Technical Activities
File Reference No. 1082-200

Comment Deadline: August 30, 2002



Financial Accounting Standards Board
of the Financial Accounting Foundation

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Summary

This proposed Interpretation would address consolidation by business enterprises of special-purpose entities (SPEs) to which the usual condition for consolidation described in Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, does not apply because the SPEs have no voting interests or otherwise are not subject to control through ownership of voting interests.

Reason for Issuing This Proposed Interpretation

Transactions involving SPEs have become increasingly common, and the existing accounting literature related to SPEs is fragmented and incomplete. Current accounting standards require an enterprise to include subsidiaries in which it has a controlling financial interest in its consolidated financial statements. That requirement usually has been applied to subsidiaries in which an enterprise has a majority voting interest, but in many circumstances, the enterprise's consolidated financial statements do not include SPEs with which it has fundamentally similar relationships. The reason is that ARB 51 focuses primarily on parent-subsidary relationships established through voting ownership interests, and the relationship between a business enterprise and an SPE is established through other means.

The Board believes that if a business enterprise has a controlling financial interest in an SPE, the assets, liabilities, and results of the activities of the SPE should be included in consolidated financial statements with those of the business enterprise (which is referred to as the primary beneficiary of the SPE in this proposed Interpretation).

The objective of this proposed Interpretation is not to restrict the use of SPEs but to improve financial reporting by enterprises involved with SPEs. Most SPEs serve valid business purposes, for example, by isolating assets or activities to protect the interests of creditors or other investors or to allocate risks among participants. Many SPEs that were unconsolidated prior to the issuance of this proposed Interpretation were reported according to the guidance and accepted practice that existed prior to this proposed Interpretation.

Differences between This Proposed Interpretation and Current Practice

Under current practice, two enterprises generally have been included in consolidated financial statements because one enterprise controls the other through voting ownership interests. This proposed Interpretation would explain how to identify an SPE that is not subject to control through voting ownership interests and would require each enterprise involved with such an SPE to determine whether it provides financial support to the SPE through a variable interest. Variable interests may arise from financial instruments, service contracts, nonvoting ownership interests, or other arrangements. If an enterprise holds (a) a majority of the variable interests in the SPE or (b) a significant variable interest that is significantly more than any other party's variable interest, that enterprise would be the primary beneficiary.

The primary beneficiary would be required to include the assets, liabilities, and results of the activities of the SPE in its consolidated financial statements. This proposed Interpretation also would require disclosure of information about the assets, liabilities, and

activities of consolidated SPEs by the primary beneficiaries and similar information about unconsolidated SPEs by enterprises that act as administrators of those SPEs.

The Board believes that this proposed Interpretation would require existing unconsolidated SPEs to be consolidated by primary beneficiaries if they do not effectively disperse risks among parties involved. SPEs that effectively disperse risks would not be consolidated unless a single party holds an interest or combination of interests that effectively recombines risks that were previously dispersed.

Qualifying SPEs, as described in FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and other SPEs with similar characteristics are examples of SPEs that disperse risks. This proposed Interpretation would not amend the provision of Statement 140 that precludes consolidation of a qualifying SPE by a transferor of assets to that SPE or its affiliates. However, another party may be required to consolidate a qualifying SPE if it holds an interest or combination of interests that effectively recombines risk.

SPEs used for leasing may not be as effective at dispersing risk as qualifying SPEs. Under current practice, a lessee consolidates an SPE lessor if the SPE does not have an outside equity investment of at least 3 percent of assets. A lender to an SPE lessor does not consolidate the SPE unless it holds a majority voting interest. Those rules would be nullified by this proposed Interpretation. For example, this proposed Interpretation would require consolidation of an SPE that leases to a single lessee by either the lessee or the lender unless the equity investor has decision-making authority and the investment meets specified conditions for sufficiency, which may require an investment significantly greater than 3 percent of assets. If an enterprise that leases from an SPE that is subject to this proposed Interpretation provides a guarantee of the value of the property at the end of the lease or otherwise accepts risk of loss from changes in value of the property, the lessee would probably consolidate the SPE lessor. If the lessee does not provide such a guarantee, the lender to the SPE would probably consolidate the SPE.

SPEs engaged in activities other than leasing or securitizations generally are not addressed by existing accounting literature. The Board has been told that existing practices related to those SPEs have been developed by analogy to requirements for SPE lessors even though their characteristics may be very different. Many of those SPEs apparently do not effectively disperse risks and would be consolidated by a primary beneficiary under this proposed Interpretation.

Notwithstanding its other provisions, this proposed Interpretation would not require consolidation of:

- a. A qualifying SPE by a transferor of assets to the SPE or its affiliates
- b. An employee benefit plan subject to the provisions of FASB Statements No. 87, *Employers' Accounting for Pensions*, No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and No. 112, *Employers' Accounting for Postemployment Benefits*, by the employer
- c. A subsidiary, division, department, branch, or other portion of a substantive operating enterprise by any other enterprise.

How This Proposed Interpretation Would Improve Financial Reporting

This proposed Interpretation is intended to achieve more consistent application of consolidation policies to SPEs and thus to improve comparability between enterprises engaged in similar activities even if some of those activities are conducted through SPEs. Including the assets, liabilities, and results of activities of SPEs in consolidated financial statements with their primary beneficiaries would provide more complete information about the resources, obligations, risks, and opportunities of the consolidated enterprise. Disclosures about SPEs that an enterprise administers but is not required to consolidate would help financial statement users assess an enterprise's risks.

How the Conclusions in This Proposed Interpretation Relate to the Conceptual Framework

FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, states that financial reporting should provide information that is useful in making business and economic decisions. Including SPEs in consolidated financial statements with the primary beneficiary will help achieve that objective by providing information that helps in assessing the amounts, timing, and uncertainty of prospective net cash flows to the consolidated entity.

Completeness is identified in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, as an essential element of representational faithfulness and relevance. Thus, to faithfully represent the total assets that an enterprise controls and liabilities for which an enterprise is responsible, assets and liabilities of SPEs for which the enterprise is the primary beneficiary must be included in the enterprise's consolidated financial statements.

FASB Concepts Statement No. 6, *Elements of Financial Statements*, defines *assets*, in part, as probable future economic benefits obtained or controlled by a particular entity and defines *liabilities*, in part, as obligations of a particular entity to make probable future sacrifices of economic benefits. The relationship between an SPE and its primary beneficiary results in control by the primary beneficiary of future benefits from the assets of the SPE even though the primary beneficiary may not have the direct ability to make decisions about the uses of the assets. Because the liabilities of the SPE will require sacrificing the assets of the SPE, those liabilities are obligations of the primary beneficiary even though the creditors of the SPE may have no recourse to the general credit of the primary beneficiary.

The Effective Date of This Proposed Interpretation

This proposed Interpretation would be applied immediately to SPEs created after the issuance date of the final Interpretation. For SPEs created before that date, the provisions of this proposed Interpretation would be applied to those SPEs still existing as of the beginning of the first fiscal year or interim period beginning after March 15, 2003.

Proposed Interpretation

Consolidation of Certain Special-Purpose Entities

an interpretation of ARB No. 51

June 28, 2002

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Proposed Interpretation

Consolidation of Certain Special-Purpose Entities

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INTRODUCTION

1. This Interpretation clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, to certain *special-purpose entities* (SPEs). Paragraph 1 of ARB 51 states that consolidated financial statements are “usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies.” Paragraph 2 states that “the usual condition for a controlling financial interest is ownership of a majority voting interest.” Many SPEs are arranged in a manner that precludes establishing a controlling financial interest through ownership of voting interests.¹

2. SPEs often are created for a single specified purpose, for example, to facilitate securitization, leasing, hedging, research and development, and reinsurance, or other transactions or arrangements. The activities may be predetermined by the documents that establish the SPE or by contracts or other arrangements between the parties involved. However, those characteristics do not define the scope of this Interpretation because some business enterprises that are not SPEs have those same characteristics.

3. The distinguishing characteristic of SPEs subject to this Interpretation is that voting equity interests do not give the holders a controlling financial interest regardless of the percentage owned.² There are two reasons why it may not be possible to establish a controlling financial interest through ownership of voting interests in an SPE. First, the SPE may be in a legal form in which there are no voting interests. Second, limitations on the activities of an SPE imposed by governing documents or contractual relationships may be so significant that they prevent the holders of voting interests from controlling the SPE. However, limits on the activities of an enterprise are not sufficient to subject that enterprise to this Interpretation because virtually all business enterprises are subject to some contractual or legal limitations.

¹The amendment of ARB 51 by FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*, removed certain exceptions to consolidation and requires consolidation of all majority-owned subsidiaries unless control does not rest with the majority owner or is temporary. FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, extends the requirement for consolidation to subsidiaries that are subject to temporary control.

²Enterprises that are not controlled by the holder of a majority voting interest because of minority veto rights as discussed in EITF Issue No. 96-16, “Investor’s Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights,” are not SPEs subject to this Interpretation if the shareholders as a group have the power to control the enterprise and the equity investment meets the other requirements of this Interpretation.

4. This Interpretation explains how to identify conditions that prevent the holders of voting interests from controlling an SPE. The Board identified four conditions that indicate that the equity investment of the nominal owners of an SPE is sufficient to permit the SPE to finance its operations. (Refer to items (b)–(e) in paragraph 9.) If one or more of the conditions do not apply, the nominal owners have not provided sufficient financial support to the SPE and that support is provided by another party (or parties). The provider (or providers) of the financial support to an SPE would not be willing to provide that support if the nominal owner retained effective decision-making power. Therefore, it is assumed that the support provider has established a controlling financial interest by taking the necessary actions to cause the SPE to serve its purposes and to prevent the nominal owners from taking actions detrimental to those purposes.

5. The first of the four conditions is that the equity investment is sufficient to permit the SPE to conduct its activities without additional financial support. The second condition is that the equity investment is the most subordinate interest in the SPE. That is, the owners' investment or the return thereon is not guaranteed and the return is not limited. The third condition is that the invested assets (the assets that the nominal owner provided in exchange for its equity interest) are not subordinated beneficial interests in another SPE (or other SPEs). (That effectively would result in two SPEs being capitalized with the same investment.) The fourth condition is that the equity investment was not provided directly or indirectly to the nominal owners by the SPE or other parties involved with the SPE.

6. If an SPE is subject to this Interpretation, each party involved with the SPE must determine whether it provides significant financial support to the SPE; for example, by holding a subordinated debt instrument or providing a guarantee of the value of the SPE's assets or liabilities. The interest through which an enterprise provides financial support to an SPE is referred to in this Interpretation as a variable interest. An enterprise that holds either a majority of the variable interests in an SPE or a significant variable interest that also is significantly more than any other enterprise's variable interest is referred to as the primary beneficiary of the SPE. The primary beneficiary of an SPE is deemed to be the parent and is required to consolidate the SPE.

INTERPRETATION

Definition of Terms

7. Certain terms are defined for use in this Interpretation as follows:
 - a. *Substantive operating enterprise* refers to an enterprise that is not an SPE. A substantive operating enterprise conducts business operations other than those performed for it by an SPE, has employees, and has sufficient equity to finance its operations without support from any other enterprise or entity except its owners. A substantive operating enterprise usually issues financial statements of its own.
 - b. *Variable interests* are the means through which financial support is provided to an SPE and through which the providers gain or lose from activities and events that change the values of the SPE's assets and liabilities. Variable interests may arise from contractual rights and obligations, such as those that result from loans or debt securities, guarantees, residual interests in transferred assets, management contracts, service contracts, leases, and similar arrangements or from nonvoting ownership interests such as preferred stock or limited partnership interests. Equity interests with voting rights are considered variable interests if they do not meet all of the conditions in paragraph 9.
 - c. *Primary beneficiary* refers to an enterprise that has a controlling financial interest in an SPE that is established by means other than holdings of voting interests. The primary beneficiary provides significant financial support to an SPE and benefits from its activities by holding a majority of the variable interests in the SPE or a significant portion of the total variable interests that is significantly more than the variable interest held by any other entity.

Scope

8. This Interpretation applies to any business enterprise that has an ownership interest, contractual relationship, or other involvement with an SPE. However, notwithstanding the other provisions of this Interpretation:
 - a. A transferor of financial assets and its affiliates shall not consolidate a qualifying SPE as defined by paragraph 35 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.
 - b. An employer shall not consolidate an employee benefit plan subject to the provisions of FASB Statements No. 87, *Employers' Accounting for Pensions*, No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and No. 112, *Employers' Accounting for Postemployment Benefits*.
 - c. No enterprise shall be deemed to be the primary beneficiary of a subsidiary, division, department, branch, or other portion of a substantive operating enterprise even if it is otherwise similar to an SPE that would be subject to the requirements of this Interpretation. For example, a subsidiary of a substantive operating enterprise

that acts as the lessor for a leveraged lease, direct financing lease, or sales-type lease shall not be consolidated with any enterprise other than its parent.

Consolidation Based on Voting Interests

9. An SPE shall be evaluated for consolidation based on voting interests instead of the provisions of this Interpretation if one or more parties hold equity investments that meet all of the following conditions:

- a. The nominal owner or owners have voting rights or similar rights that convey the current ability to make decisions and manage the SPE's activities to the extent they are not predetermined by the establishing documents of the SPE or by contracts or other arrangements.
- b. The amount of the equity investment is sufficient to allow the SPE to finance its activities without relying on financial support from variable interest holders. That is, the investment is large enough to enable the SPE to conduct its activities or finance its activities without direct or indirect assistance from holders of variable interests. Generally, that means that the equity investment should be greater than or equal to the expected future losses³ of the SPE at all times during the SPE's existence.⁴
- c. The equity investment is subordinate to all other equity investments and other interests for the entire life of the SPE. That is, it is the first interest subject to loss if the SPE's assets are not sufficient to meet its obligations, and its return is not limited or guaranteed directly or indirectly by the SPE or other parties involved with the SPE.
- d. The assets exchanged for the equity interest are not subordinated beneficial interests in another SPE (either substantive voting equity interests or variable interests).
- e. The equity investment was not provided directly or indirectly by the SPE or other parties with variable interests in the SPE (for example, by fees, charitable contributions, or other payments) and was not financed directly or indirectly by the SPE or other parties with variable interests.

10. A party that makes an equity investment that fails to meet one or more of the conditions in paragraph 9 shall consider that investment as a variable interest to be assessed under the provisions of this Interpretation.

11. Condition (b) in paragraph 9 requires an enterprise to make a judgment about the sufficiency of the equity investment in an SPE to determine whether it is subject to this Interpretation. An enterprise shall reconsider whether the equity investment is sufficient to

³The term *expected* in this Interpretation has the same meaning as in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*. *Expected future losses* refers to a probability-weighted estimate of losses without considering possible gains. For example, if there is a 10 percent chance of a total loss by an SPE with assets of \$100 and no other probabilities of loss, the expected loss is \$10.

⁴This condition is not intended to apply to enterprises that were previously considered substantive operating enterprises that no longer have sufficient equity to finance their own activities because of operating losses, for example, enterprises in bankruptcy or nearing bankruptcy that formerly had sufficient equity to operate without additional financial support.

finance the activities of the SPE at each reporting date. In making that judgment, an enterprise shall compare the amount of the equity investment with the amount of equity invested in substantive operating enterprises with similar assets and liabilities, similar activities, and similar risks if that information is available. For example, an enterprise that holds only high-quality assets with little variability in cash flows and that has no significantly variable liabilities or contingent liabilities may be able to operate with a smaller equity investment than an enterprise engaged in higher risk activities such as trading in derivative instruments or conducting research and development activities. If no information about comparable substantive operating enterprises is available, the enterprise shall determine whether the equity invested in the SPE is greater than or equal to expected future losses. (Refer to paragraph 9(b).)

12. An equity investment shall be presumed to be insufficient to allow the SPE to finance its activities without relying on financial support from variable interest holders unless the investment is equal to at least 10 percent of the SPE's total assets. For purposes of that presumption, the investment and the total assets shall be measured according to generally accepted accounting principles in the United States. The presumption is overcome only if there is persuasive evidence that an equity investment of less than 10 percent of total assets is comparable to the equity of businesses that are not SPEs and that engage in similar transactions with similar risks. An equity investment of 10 percent or more of total assets is not presumed to be sufficient, but an investment of that amount is sufficient if it allows the SPE to finance its own activities as discussed in paragraph 9(b).

Consolidation Based on Variable Interests

13. An SPE shall be evaluated for consolidation based on variable interests if it does not meet all of the conditions described in paragraphs 9–12. An enterprise involved with such an SPE shall determine at each reporting date whether it is the primary beneficiary of the SPE as follows:

- a. The enterprise shall determine whether it provides significant financial support to the SPE through a variable interest. If the SPE holds certain financial assets and meets the conditions in paragraph 22, variable interests shall be evaluated according to the special provisions in paragraph 23. Otherwise, variable interests shall be evaluated according to the more general provisions in paragraphs 18–21. If the enterprise does not provide significant financial support, it is not the primary beneficiary.
- b. If the enterprise provides financial support through a variable interest, the enterprise shall determine whether any other party or parties also provide financial support to the SPE through variable interests. If no other parties provide financial support, the enterprise is the primary beneficiary.
- c. If other parties provide financial support, the enterprise is the primary beneficiary if it provides a majority of the financial support or a significant portion of the total financial support that is significantly more than any other party. That is, the enterprise shall determine whether it has either (1) a majority of the variable interests or (2) a variable interest that is a significant portion of the total variable

interests and that is significantly more than the variable interests held by any other individual party.

If an enterprise determines that it is the primary beneficiary of an SPE, the enterprise shall consolidate that SPE.

14. All factors influencing consolidation decisions shall be reconsidered at each reporting date using all evidence that the enterprise possesses or would reasonably be expected to possess.⁵ The initial measurement of the assets, liabilities, and noncontrolling interests of the SPE shall be fair value at the time the enterprise becomes the primary beneficiary. An enterprise shall not restate previously issued financial statements if it becomes the primary beneficiary of an SPE subsequent to inception of the SPE or if it ceases to be the primary beneficiary of an SPE.

15. An enterprise that has a variable interest in an SPE shall treat other variable interests in that SPE held by its related parties (as identified in FASB Statement No. 57, *Related Party Disclosures*) as its own interests for purposes of determining whether it is the primary beneficiary. An enterprise also shall treat variable interests held by the following parties as its own interests:

- a. Another SPE of which the enterprise is the primary beneficiary
- b. A party that cannot fund or finance its operations without support from the enterprise
- c. A party that has a de facto agency relationship with the enterprise as a result of an agreement that it cannot sell, transfer, or encumber its interests in the SPE without the prior approval of the enterprise
- d. A party that received its interests as a contribution from the enterprise
- e. A party that has a de facto agency relationship with the enterprise as a result of providing significant amounts of professional services or similar business arrangements.

16. An SPE can have only one primary beneficiary. If two or more of the parties described in paragraph 15 hold variable interests in the same SPE, and the aggregate variable interest held by those parties would, if held by a single party, identify that party as the primary beneficiary as described in paragraph 13, the following guidelines shall be used for deciding which is the primary beneficiary:

- a. Only a party that is a substantive operating enterprise can be a primary beneficiary.
- b. If two or more parties with variable interests have agency relationships, the principal is the primary beneficiary.
- c. If the relationship is not that of a principal and an agent, the party with activities that are most closely associated with the SPE is the primary beneficiary.

⁵An entity is not required to conduct an exhaustive search for information about the actions of other unrelated parties that might cause the entity to become the primary beneficiary or to cease to be the primary beneficiary.

- d. If it is not apparent which party's activities are most closely associated with the SPE's activities, the party with the largest variable interest is the primary beneficiary.

17. If contractual or other legal provisions or agreements substantially restrict an enterprise's rights and obligations to specifically identified assets of an SPE and the interests of the creditors of the SPE apply equally to all of the SPE's assets, that enterprise shall treat those assets and the portions of the SPE's liabilities attributable to those assets as a separate SPE.⁶

Identifying and Comparing Variable Interests

18. Variable interests generally subject the holder to a risk of losing an investment in the SPE or incurring a loss as a result of a contingent obligation to transfer assets or issue securities to the SPE. The following are some of the ways in which variable interests can arise:

- a. Ownership interests that do not meet the conditions in paragraph 9
- b. Loans, especially subordinated debt
- c. Leases
- d. Management contracts or other service contracts (Refer to paragraph 19.)
- e. Referral agreements
- f. Options to acquire assets
- g. Purchase contracts
- h. Credit enhancements, such as overcollateralization provided by a transferor or seller of assets to an SPE
- i. Guarantees of debt or asset values
- j. Derivative instruments.

19. Contracts to provide services to an SPE in return for a fee negotiated at arm's length under competitive conditions (a market-based fee) are not variable interests unless the holder has an investment at risk or can be required in certain circumstances to transfer assets or issue its own equity or debt instruments to the SPE or a party with an interest in the SPE. However, if the amount of a service provider's fee is variable and it can be demonstrated that the service provider made a significant incremental investment in its own business in order to earn the fee, that investment also should be considered in determining if the enterprise has a variable interest. A provider of services to SPEs also may receive other interests in the SPE at no cost or at favorable prices in addition to or in lieu of its cash fee. Because it can be difficult to determine whether a fee (which may include cash and other interests in the SPE) is market based, an enterprise shall presume that its fee from an SPE is not market based unless it can be demonstrated to be comparable to fees in similar observable arm's length transactions or arrangements.⁷

⁶The portions of an SPE referred to in this paragraph are sometimes called silos.

⁷The term *fees* as used in this context refers to cash or other assets received plus any other benefits. Some examples of other benefits are other interests in the SPE and a servicer's right to earn interest on cash received from debtors but not yet due to be disbursed to creditors or beneficial interest holders.

20. The relative size of variable interests shall be determined by comparing expected future losses from the interests. (Refer to paragraph 9(b).) If two enterprises have variable interests in the same SPE with similar expected future losses and those interests have different characteristics, the interest that is subordinate to (subject to loss before) other variable interests shall be given more weight.

21. If two enterprises have variable interests in the same SPE of similar size and neither variable interest is subordinate to the other, the specific risk to which a variable interest is subject shall be considered. A variable interest subject to the dominant risk in an SPE shall be given more weight. The dominant risk in an SPE is the one that is most likely to cause a significant change in the cash flows of an SPE. For example, price risk for a nonfinancial asset held by a leasing SPE can cause a change in cash flows at the end of the lease. Credit risk can cause a change in cash flows related to most loans and debt securities, and risks related to the underlying of significant derivatives can cause changes in cash flows related to the derivatives.

SPEs That Hold Certain Financial Assets

22. Variable interests in the following two categories of SPEs that hold financial assets shall be evaluated according to the provisions of paragraph 23:

- a. Qualifying SPEs that do not hold equity securities. Qualifying SPEs are defined in paragraph 35 of Statement 140, and other paragraphs referenced in paragraph 35.
- b. SPEs that meet all of the conditions in paragraph 35 of Statement 140 and other paragraphs referenced in paragraph 35 except that:
 - (1) They may hold equity securities only temporarily and then only if those equity securities are obtained as a result of collecting financial assets held by the SPE.⁸
 - (2) They are not necessarily restricted to acquiring their assets by transfer from a transferor as described in Statement 140.
 - (3) They are not necessarily subject to the restrictions on sales of assets described in paragraphs 42–45 of Statement 140.

23. An enterprise involved with an SPE of the type described in paragraph 22 is considered to provide significant financial support through a variable interest only if it meets at least two of the following three conditions:

- a. It has authority to purchase and sell assets for the SPE and has sufficient discretion in exercising that authority to significantly affect the revenues, expenses, gains, and losses of the SPE.
- b. It provides a guarantee, a back-up lending arrangement, or other form of liquidity, credit, or asset support that is subordinate to the interests of other parties.
- c. It receives a fee that is not market based. (Refer to paragraph 19.)

⁸This requirement is very similar to the provisions of paragraph 41 of Statement 140, which discusses nonfinancial assets held by qualifying SPEs. Refer to that paragraph for additional guidance on the application of this provision.

If no enterprise meets at least two of those three conditions, that SPE has no primary beneficiary. An enterprise that meets at least two of those conditions provides significant financial support through a variable interest and shall follow the guidance in items (b) and (c) of paragraph 13 (because two enterprises could meet two of those conditions).

DISCLOSURE

24. In addition to any disclosures that may be required by other standards, a primary beneficiary of an SPE shall disclose, either in the notes to the financial statements or on the face of the statement of financial position, the carrying amount and classification of assets of a consolidated SPE that are collateral for the SPE's obligations. If the creditors (or beneficial interest holders) of a consolidated SPE have no recourse to the general credit of the primary beneficiary, that lack of recourse shall be disclosed either in the notes to the financial statements or on the face of the statement of financial position.

25. An enterprise that (a) provides significant administrative services to an SPE such as collecting and distributing cash or placing interests issued by the SPE and (b) is not the primary beneficiary shall disclose the assets and liabilities of the SPEs that it serves and shall describe the purpose of those SPEs.

EFFECTIVE DATE AND TRANSITION

26. The provisions of this Interpretation shall be applied immediately to all SPEs created after the date the Interpretation is issued. The provisions of this Interpretation shall be applied as of the beginning of the first fiscal period beginning after March 15, 2003 to SPEs created before the issuance date of this Interpretation and still existing on March 15, 2003. The individual assets, liabilities, and noncontrolling equity interests of an SPE that is consolidated as a result of applying this Interpretation initially shall be recognized at their fair values at the date the Interpretation is first applied. Any effect on equity in the primary beneficiary's consolidated financial statements of initially reporting the assets, liabilities, and noncontrolling equity interest of a consolidated SPE shall be reported in a manner similar to the cumulative effect of a change in an accounting principle.

27. Pro forma disclosure of the effect this Interpretation would have had on the total assets, total liabilities, income before extraordinary items, and net income in periods reported before the Interpretation was first applied is encouraged. Early application also is encouraged.

Appendix A

EXAMPLES

Introduction

A1. This appendix presents examples that explain or illustrate the application of certain provisions of this Interpretation to certain types of arrangements. This appendix discusses generalized situations and does not illustrate all possible types or uses of SPEs. Facts and circumstances and specific arrangements need to be considered carefully in applying this Interpretation.

Limits or Guarantees Related to Equity Investments by Variable Interest Holders

A2. Paragraph 9(c) states an SPE shall be evaluated for consolidation based on voting interests if the equity investment is subordinate to all other interests for the entire life of the SPE and its return is not limited or guaranteed directly or indirectly by the SPE or other parties involved with the SPE. Some examples of arrangements that cause an SPE not to meet those conditions are:

- a. A variable interest holder will reimburse the SPE or the nominal owner (or owners) for losses or has made arrangements for another party to do so.⁹
- b. The allocation of the SPE's cash flows effectively removes the risk of loss from the nominal owners.
- c. A variable interest holder other than the nominal owner provides a standby letter of credit to the SPE, provides credit enhancements for its assets, guarantees its debt, or has arranged for another party to do so.¹⁰
- d. A variable interest holder other than the nominal owner guarantees residual values of the SPE's assets or agrees to future purchases of the SPE's assets at predetermined prices that protect the interests of other variable interest holders or lenders or has made arrangements for another party to do so.
- e. A variable interest holder has entered into a total return swap with the SPE.
- f. A variable interest holder also is an equity owner and is allocated a proportional amount of the first dollars of loss, or the nominal owners otherwise share exposure to the first dollars of loss with variable interest holders. That would occur, for example, if the SPE enters into a swap that reimburses the equity owner (or owners) for 90 percent of any losses the SPE incurs.

⁹Under the requirements in paragraph 5 of FASB Statement No. 68, *Research and Development Arrangements*, if the primary beneficiary of a research and development SPE is obligated to repay any of the funds provided by the other parties regardless of the outcome of the research and development, the primary beneficiary shall estimate and recognize that liability.

¹⁰However, guarantees and other arrangements that protect lenders to the SPE after the equity owner has suffered a total loss of its investment do not prevent the equity owner (or owners) from having the substantive risks of ownership.

- g. Predetermined distribution arrangements limit the residual interest of the SPE to either a nominal portion of the SPE's net cash flows or an amount that lacks significant variability.
- h. A variable interest holder has the right to receive most of any benefits other than cash that may result from the SPE's activities at a price that is less than the fair value of those benefits. Some examples of such benefits are rights to inventions, new products, or new processes.
- i. The nominal owners' equity investment interests have repayment provisions that are similar to the provisions of debt obligations or that otherwise limit the holder to a rate of return commensurate with the risk in debt instruments.

Examples of SPEs and Primary Beneficiaries

A3. The following table describes activities often conducted by SPEs and identifies the entity most likely to be the primary beneficiary. The list is not intended to be exhaustive. Other situations and transactions also may involve SPEs.

Activity

Probable Primary Beneficiary

Securitizing financial assets

If the SPE meets the conditions in paragraph 22, only an entity that meets at least two of the three conditions in paragraph 23 can be the primary beneficiary. If the SPE is not a qualifying SPE and does not meet the other condition in paragraph 22, the primary beneficiary may be the transferor, the servicer of the assets, or the entity that provides subordinated credit or credit protection. If the SPE is a qualifying SPE that does not meet the conditions in paragraph 22, the primary beneficiary may be the servicer of the assets, or the entity that provides subordinated credit or credit protection. Because of the specific exception in paragraph 8(a), neither a transferor nor its affiliates are required to consolidate a qualifying SPE even if it is the primary beneficiary.

Leasing real estate, production facilities, or equipment

If the lessee does not provide a residual value guarantee or make other arrangements that ensure that the value of the SPE's assets will be sufficient to meet its obligations at the end of the lease term, the lender to the SPE is the probable primary beneficiary. If the lessee provides a residual value guarantee or makes other arrangements to ensure the value of the SPE's assets or liabilities, the lessee to the SPE is the probable primary beneficiary.

Activity

Buying and holding inventory¹¹

Performing (or contracting for performance of) research and development or development activities such as medical technology, drugs, electronic devices, software, and movies¹²

Performing (or contracting for performance of) exploration and/or development of natural resources

Owning and funding start-up operations such as retail stores, restaurants, and nursing and retirement facilities

Originating loans or buying, holding, and selling financial instruments (for example, collateralized debt obligations and loan conduits)

Monetizing future cash flows other than those from financial instruments¹³

Acting as a counterparty to a derivative contract

Probable Primary Beneficiary

The entity that is seeking to finance inventory pending its future use or resale is the probable primary beneficiary.

An entity that has the right to acquire the SPE or the results of the SPE's efforts at less than fair value is the probable primary beneficiary.

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If the SPE meets the conditions in paragraph 22, only an entity that meets at least two of the three conditions in paragraph 23 can be the primary beneficiary. If the SPE does not meet the conditions in paragraph 22, the primary beneficiary may be the administrator, the entity that provides credit protection, or a holder of subordinated debt or nonvoting equity interests.

An entity that transfers the right to future cash flows in exchange for variable interests is the probable primary beneficiary.

The entity that bears the risk of losing a variable interest in the SPE is the probable primary beneficiary.

¹¹FASB Statement No. 49, *Accounting for Product Financing Arrangements*, also must be considered in determining how to account for those arrangements.

¹²Statement 68 and Issue 99-16 also must be considered in determining how to account for those arrangements.

¹³In addition to applying the guidance in this Interpretation, consideration should be given as to whether this arrangement is a sale of future revenue (and not a financial instrument) that should be treated as a financing arrangement rather than a potential gain-loss transaction. Refer to EITF Issue No. 88-18, "Sales of Future Revenues."

Appendix B

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

B1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this Interpretation. It includes reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.

Objective of This Interpretation

B2. Transactions involving SPEs have become increasingly common, and the existing accounting literature related to SPEs is fragmented and incomplete. Some enterprises appear to have used SPEs to avoid reporting assets and liabilities for which they are responsible, to defer the reporting of losses that have already been incurred, or to report gains that are illusory. However, many SPEs have been used for valid business purposes and were not consolidated by any party based on guidance and accepted practice prior to this Interpretation.

B3. The objective of this Interpretation is to provide principles for determining when an enterprise should include the assets, liabilities, and results of activities of an SPE in its consolidated financial statements. The traditional reason for including two or more enterprises in consolidated financial statements is described in ARB 51. ARB 51 states that consolidated financial statements are “usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies.” ARB 51 states further that “the usual condition for a controlling financial interest is ownership of a majority voting interest.”

B4. The relationship formed by a controlling financial interest is called a parent-subsidary relationship. Some relationships between enterprises and SPEs are similar to a relationship established by a majority voting interest, but the SPEs often are arranged without a governing board or with a governing board that has limited ability to make decisions that control the SPE’s activities. The activities of SPEs often are limited or predetermined by the articles of incorporation, bylaws, partnership agreements, trust agreements, other establishing documents, or contractual agreements between the parties involved with the SPE. In those circumstances, the SPE can be made to serve the purposes of another enterprise by means other than voting interests. Prior to this Interpretation, there were no effective accounting principles for determining when and if that type of relationship between an enterprise and an SPE exists.

B5. A business enterprise that has a parent-subsidary relationship with an SPE that is not subject to control through voting interests is referred to in this Interpretation as a *primary beneficiary*. The activities of the SPE are made to serve the purposes of the primary beneficiary by contracts or other agreements or by the documents that established the SPE or created the interests in the SPE. In return, the primary beneficiary provides

significant financial support for the SPE. The Board concluded that parent-subsidary relationships should require consolidation regardless of the mechanism used to establish the relationship and, therefore, the assets, liabilities, and results of the activities of an SPE should be included in consolidated financial statements with those of its primary beneficiary.

Background Information

B6. Various EITF Issues and SEC staff announcements address issues that directly or indirectly relate to SPEs. That guidance and the effects of this Interpretation are summarized in Appendix C. Statement 140, which is discussed in other parts of this Interpretation, establishes standards of accounting for transfers of financial assets to SPEs.

Distinguishing between Enterprises Subject to Consolidation by Owners of Voting Interests and SPEs Subject to This Interpretation

B7. Paragraph 9 describes five conditions that would subject an SPE to consolidation based on an evaluation of voting interests as provided in ARB 51. Paragraphs 2–5 in the Introduction of this Interpretation explain the reasons that the Board believes those characteristics are appropriate. The absence of any one of those conditions indicates that the nominal owners of an SPE do not control the SPE.

B8. Condition 9(a) is that the nominal owners have voting rights or similar rights that give them an ability to make decisions to the extent they are not predetermined. Conditions 9(b) and 9(c)—sufficiency to finance the SPEs activities and subordination to all other interests—are fundamental features of an equity investment in a traditional business enterprise in corporate form. Conditions 9(d) and 9(e) are intended to prevent some of the abuses that the Board has been told have occurred in the past. Condition 9(d) is intended to prevent one SPE from holding a variable interest in a chain of other SPEs, that is, to prevent a single equity investment from being used to capitalize several SPEs. Condition 9(e) is intended to prevent disguising the identity of the enterprise that is providing the real financial support for the SPE. It could be argued that those two provisions are not necessary if the other provisions of the Interpretation are applied in good faith. However, the Board has included those two conditions to make the intention of this Interpretation clear.

B9. This Interpretation includes a presumption that an equity investment is insufficient to allow an SPE to finance its activities unless the investment is equal to at least 10 percent of the SPE's total assets. The Board established that presumption as a benchmark to emphasize that the requirement for 3 percent equity in Issue 90-15 is superseded and that an equity investment as small as 3 percent is not likely to be sufficient for most SPEs. The Board intended that presumption to apply in one direction only; that is, an equity investment of less than 10 percent is presumed to be insufficient, but an equity investment of 10 percent is not presumed to be sufficient.

Identifying a Primary Beneficiary Based on Variable Interests

B10. If an SPE is subject to this Interpretation, each party involved with the SPE must determine whether it provides significant financial support to the SPE, for example, by holding a subordinated debt instrument or providing a guarantee of the value of the SPE's assets or liabilities. The interest through which that financial support is provided and by which the providers gain or lose from activities and events that change the values of the SPE's assets and liabilities is referred to in this Interpretation as a variable interest. An enterprise is referred to as the primary beneficiary of an SPE if it holds either a majority of the variable interests in the SPE or a significant portion of the variable interests that is significantly more than any other enterprise's variable interest. The primary beneficiary of an SPE is deemed to have a controlling financial interest and is required to consolidate the SPE even though the "usual condition" for consolidation in ARB 51 is not present.

B11. The Board considered the characteristics of parent-subsidary relationships created by majority voting interests to determine whether any of those characteristics might be present in relationships between an SPE subject to this Interpretation and parties with contractual relationships or other types of involvement with that SPE. The characteristics of a parent-subsidary relationship that the Board identified as fundamental to assessing relationships with SPEs are (a) the parent's responsibility or desire to provide financial support for the subsidiary and the resulting exposure to losses if the subsidiary's activities do not generate a profit and (b) the parent's ability to realize a rate of return that is limited only by the nature of the subsidiary's assets and liabilities and the parent's skill in using the subsidiary's resources (although it may share the return with other investors).

B12. In conventional parent-subsidary relationships, the financial support is provided and the returns on investment (both positive and negative) are obtained primarily through an investment in voting ownership interests such as common stock. By definition, an SPE covered by this Interpretation is not part of a conventional parent-subsidary relationship. There are no voting equity interests or the voting equity interests do not provide sufficient financial support for the SPE to conduct its activities. Consequently, an SPE subject to this Interpretation requires additional financial support in some other form, and the provider of that financial support will demand compensation for taking the risk. The party (or parties) that supports an SPE financially may make an investment that, regardless of its form, is effectively subordinate to most other obligations of the SPE. Financial support might take one of the following forms: investments in ownership interests (that are not sufficient to exclude the SPE from this Interpretation), subordinated debentures, other subordinated financial instruments, derivative instruments, and subordinated interests in assets transferred to the SPE as part of the compensation for those assets.

B13. Alternatively, a supporting party may commit to provide assets or issue its own debt or equity securities to the SPE or other parties with interests in the SPE. Some examples of commitments that support an SPE financially are (a) guarantees of minimum values of the SPE's assets, (b) guarantees that creditors will receive the amounts due, (c) commitments to purchase some or all of the SPE's assets at prices that will permit the SPE

to fulfill its obligations, and (d) commitments to lend to the SPE under certain conditions. The common factor is that the commitment is subordinated to other interests in the SPE.

B14. Investments or commitments or combinations of the two that provide the necessary financial support to an SPE without a sufficient substantive voting equity investment are referred to in this Interpretation as variable interests. Economically, the holders of variable interests would not be willing to provide an SPE with the type of support normally provided by equity investors without an expected return commensurate with the risk of an equity investment. The variable interest holders also will protect their interests (manage their risks) either by establishing predetermined limits on the SPE's activities or by wielding decision-making authority in some form other than a voting interest.

B15. The Board reasoned that providers of financial support to an SPE would be expected to have risks and opportunities to benefit (risks and rewards) that are of the same character as those of an equity investor. At the same time, they arrange to protect their investment through means other than ownership of voting shares. Effectively, the providers of financial support are in the same position as parents in a conventional parent-subsidiary relationship, except that the mechanism that establishes the relationship is different. The Board concluded that the assets, liabilities, and results of activities of an SPE and its financial support provider (primary beneficiary) should be included in consolidated financial statements.

B16. More than one unrelated entity may provide financial support to (hold a variable interest in) an SPE. The primary beneficiary provides either a majority of the financial support or significant financial support that is significantly more than any other variable interest holder provides. If no party meets that condition, the risks and opportunities inherent in the SPE's assets and liabilities have been diversified to the extent that consolidation of the SPE is inappropriate.

B17. Some have argued that an enterprise should consolidate an SPE only if it has a majority of the variable interests in that SPE. The Board acknowledges that an entity's variable interest takes on decreased significance as its absolute size diminishes. However, a parent has never been required to have a majority of risks and benefits from its subsidiary in order to consolidate that subsidiary. This Interpretation does not change that.

SPEs Consolidated by Substantive Operating Enterprises

B18. The Board considered whether an entity that is consolidated by a substantive operating enterprise (or a group of assets and related liabilities held by a substantive operating enterprise) could be an SPE covered by this Interpretation. An example is a subsidiary in which a parent has a very small equity investment that leases property financed by nonrecourse debt to a single lessee. If the lessee provides a residual value guarantee or if other provisions in the lease expose the lessee to essentially all of the risks related to the price of the leased property, the lessee could be considered the primary beneficiary of those assets and liabilities. However, the Board decided that an SPE-like subsidiary or group of assets and liabilities included in consolidated financial statements

of a substantive operating enterprise should not be subject to the provisions of this Interpretation. If they were, the same assets and liabilities could be reported in consolidated financial statements of two different and otherwise unrelated enterprises. That duplication would be avoided if the substantive operating enterprise were required to cease reporting those assets and liabilities in its financial statements. However, the Board believes it is not appropriate to address derecognition in this Interpretation, which is intended to clarify when SPEs should be consolidated.

Special Provisions for Certain SPEs That Hold Financial Assets

B19. In its deliberations, the Board acknowledged that while many SPEs benefit a primary beneficiary, some SPEs effectively diversify risks and potential benefits related to certain assets or activities. In SPEs that diversify risks, a portfolio of assets is held by an administrator, trustee, or servicer, and the various rights and obligations that arise from those assets and any liabilities incurred to hold those assets are allocated to various parties in accordance with their tolerance for risk. No individual party controls the SPE's assets or is responsible for the SPE's liabilities. Each party should account for its rights and obligations related to the assets in the SPE, but it is inappropriate for any party to consolidate the assets and liabilities of the SPE.

B20. The Board believes that appropriate application of the provisions of this Interpretation would not result in consolidation of SPEs that effectively disperse risks. However, to simplify implementation and improve consistency, the Board decided to provide additional, more specific guidance on how to analyze one class of risk-dispersing SPEs, which are described in paragraph 22. That class of SPEs hold certain financial assets, have limits on their activities and the interests they can issue, and are legally isolated from the enterprises that hold interests in them.

B21. The criteria for qualifying SPEs in paragraph 35 of Statement 140 and other paragraphs referenced in paragraph 35 form the basis for identifying SPEs to which the special provisions in paragraph 23 of this Interpretation apply. Those criteria were developed from the perspective of the transferor of financial assets because Statement 140 addresses transfers of assets. As a result, certain differences in criteria were needed for this Interpretation because it addresses a broader range of SPEs.

B22. One significant difference between qualifying SPEs described in Statement 140 and the SPEs described in paragraph 22 of this Interpretation is that paragraph 22 includes SPEs that purchase their assets in market transactions or that originate loans. The Board does not believe that acquiring assets from transferors in exchange for beneficial interests in the SPE that is the transferee is a necessary condition for diversification of risk. That provision is included in Statement 140 because Statement 140 addresses only transfers.

B23. A second significant difference between the criteria in paragraph 22 and the criteria for qualifying SPEs in Statement 140 is that the criteria in paragraph 22 exclude SPEs that hold equity interests in corporations, partnerships, and other legal entities. Statement 140 permits qualifying SPEs to hold equity investments as long as they are passive; that is, the SPE cannot exercise any voting rights or conversion rights or make other active choices.

That Statement also prohibits selling the equity securities to realize gains, which is not prohibited by this Interpretation.

B24. Some of the SPEs addressed by this Interpretation have more flexibility in selling assets than do qualifying SPEs in Statement 140, and there is a greater possibility that the SPE's activities will encompass trading equity securities for the benefit of interest holders. The more active an SPE is and the more choices its managers can make, the more likely it is that those managers (or the parties responsible for naming those managers) have the significant risks and opportunities for benefit inherent in that SPE's activities. The Board acknowledges that SPEs that hold equity securities may diversify risk effectively enough that they do not have primary beneficiaries under the basic provisions of this Interpretation. However, the Board did not want to extend the special provisions for simplified analysis to them because they may not all effectively diversify risk.

B25. Some SPEs issue beneficial interests that legally are in the form of equity securities. Holding beneficial interests in an issuing SPE that are designated as equity interests would not automatically cause the holding SPE to violate the special provisions unless the issuing SPE holds equity interests or other assets that would disqualify the holding SPE if it held the assets directly.

Related Parties

B26. The Board believes that identification of parties related to variable interest holders is essential. For example, if a party related to the holder of a significant variable interest in an SPE has decision-making power for that SPE, that party can function as an agent for the variable interest holder. For that reason, the Board believes that the variable interests of related parties should be considered on a combined basis for purposes of determining whether the potential primary beneficiary should consolidate the SPE.

B27. This Interpretation treats certain parties other than those identified in Statement 57 in the same manner as related parties of a variable interest holder. Those other parties (a) are financially dependent on a variable interest holder, (b) cannot sell, transfer, or encumber their interests without the approval of a variable interest holder, (c) receive the investment or the funds to make the investment from a variable interest holder, or (d) provide significant amounts of professional services or other similar services to a variable interest holder. That provision was included in this Interpretation to prevent a variable interest holder from avoiding consolidation of an SPE by arranging to protect its interest or indirectly expand its holdings through other parties.

Appendix C

EFFECT OF THIS INTERPRETATION ON EITF ISSUES

C1. The provisions of this Interpretation nullify the consensuses in the following EITF Issues and the guidance in the following EITF Topic:

- a. Issue No. 90-15, “Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions”

The Task Force indicated that a lessee is required to consolidate an SPE lessor at the inception of a lease when (1) substantially all of the activities of the SPE involve assets that are to be leased to a single lessee, (2) the expected substantive residual risks and substantially all the residual rewards of the leased assets and the obligation imposed by the underlying debt of the SPE reside directly or indirectly with the SPE, and (3) the owners of record of the SPE have not made an initial substantive residual equity capital investment that is at risk during the entire term of the lease. If those three criteria are met, the lessee is required to consolidate the lessor SPE. The SEC staff’s answer to Question No. 3 states, in part: “The SEC staff understands from discussions with Working Group members that those members believe that 3 percent is the minimum acceptable investment. The SEC staff believes a greater investment may be necessary depending on the facts and circumstances, including the credit risk associated with the lessee and the market risk factors associated with the leased property.”

Those requirements are nullified by this Interpretation, which requires that unless an SPE meets the conditions in paragraph 9, an enterprise should consolidate that SPE if it determines, based on the provisions of this Interpretation, that it is the primary beneficiary.

- b. Issue No. 96-20, “Impact of FASB Statement No. 125 on Consolidation of Special-Purpose Entities”

The Task Force indicated that the Statement 125 definition of control should be applied when assessing whether an SPE should be consolidated only when all of the following criteria are met:

1. The entity being considered is a qualifying SPE that meets all of the conditions of paragraph 26 of FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. As a result, the SPE has a standing at law distinct from the transferor, and its activities are permanently limited to those set forth in paragraph 26 of Statement 125.
2. The assets held by the qualifying SPE are financial assets, such as receivables from credit cards, mortgage loans, or securities that represent a

contractual right to cash (or another financial instrument) from, or an ownership interest in, an entity that is unrelated to the transferor.

3. The financial assets held by the qualifying SPE are not the result of a structured transaction (or a series of transactions) that has the effect of (a) converting nonfinancial assets (for example, real estate or servicing assets) into a financial asset or (b) recognizing previously unrecognized financial assets.

Further, the Task Force indicated that for other SPEs, the transferor (or sponsor or creator, as applicable) should continue to apply the consolidation criteria of Topic D-14 and Issue 90-15 as appropriate.

Those requirements are nullified by this Interpretation, which requires that if the SPE does not meet the conditions in paragraph 9, an enterprise should consolidate the SPE if it determines, based on the provisions of this Interpretation, that it is the primary beneficiary.

- c. Topic No. D-14, “Transactions involving Special-Purpose Entities”

The SEC Observer noted that the SEC staff believes that nonconsolidation and sales recognition are not appropriate by the sponsor or transferor of an SPE when the majority owner of the SPE makes only a nominal capital investment, the activities of the SPE are virtually all on the sponsor’s or transferor’s behalf, and the substantive risks and rewards of the assets or the debt of the SPE rest directly or indirectly on the sponsor or transferor.

That requirement is nullified by this Interpretation, which requires that if the SPE does not meet the criteria in paragraph 9, an enterprise should consolidate the SPE if it determines, based on the provisions of this Interpretation, that it is the primary beneficiary.

C2. The provisions of this Interpretation partially nullify the consensuses in the following EITF Issues:

- a. Issue No. 96-21, “Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities”

The Task Force reached consensus on a number of issues related to implementation of the first and third conditions of Issue 90-15, which is nullified by this Interpretation. The questions that relate to implementation of those conditions are no longer necessary. Thus, this Interpretation nullifies Questions No. 1, 2, 3, 5, 7, 8, and 9 of Issue 96-21, and the portion of the response to Question No. 6 related to the accounting effect from the SPE’s perspective of a requirement that a lessee pay fees for structuring a lease transaction, as it relates to the application of Issue 90-15.

- b. Issue No. 97-1, “Implementation Issues in Accounting for Lease Transactions, including Those involving Special-Purpose Entities”

The Task Force reached consensus on the method of calculating depreciation for the purposes of determining earnings in applying the third condition of Issue 90-15, which is nullified by this Interpretation.

Questions that relate to implementation of those conditions are no longer necessary as the conditions have been nullified by this Interpretation. Thus, this Interpretation nullifies Question No. 3 of Issue 97-1 on the topic of depreciation.

C3. The provisions of this Interpretation bring conclusion to EITF Issue No. 84-30, “Sales of Loans to Special-Purpose Entities,” for which the Task Force was unable to reach consensus.

C4. This Interpretation does not nullify EITF Issue No. 96-16, “Investor’s Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights.” An enterprise that is not controlled by the holder of a majority voting interest because of minority approval or veto rights is not subject to this Interpretation unless the majority and minority shareholders in combination do not control the enterprise.